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Vice President
Government & Community Affairs

December 15, 2009

PUBLIC UTILITIES
COMMISSION

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The Honorable Chairman and Members
of the Hawaii Public Utilities Commission
Kekuanaoa Building, First Floor
465 South King Street
Honolulu, Hawaii 96813

Dear Commissioners:

Subject: Docket No. 2008-0083 – Hawaiian Electric 2009 Test Year Rate Case
Proposed Second Interim Decision and Order

On November 19, 2009, Hawaiian Electric Company, Inc. ("Hawaiian Electric") filed a *Motion for Second Interim Increase for CIP CT-1 Revenue Requirements, or in the Alternative, to Continue Accruing AFUDC for the CIP CT-1 Project*. In conjunction with its motion, Hawaiian Electric submits the attached proposed second interim decision and order for the Commission's use.

Should the Commission have any questions, please call Dean K. Matsuura at 543-4622.

Sincerely,

Attachment

cc: Division of Consumer Advocacy
Dr. Kay Davoodi, Department of Defense
James N. McCormick, Department of Defense
Theodore E. Vestal, Department of Defense

Attachment

SECOND INTERIM DECISION AND ORDER

By this Second Interim Decision and Order, the commission approves the request by HAWAIIAN ELECTRIC COMPANY, INC. ("HECO")¹ to increase its rates on an interim basis, as set forth in HECO's Motion for Second Interim Increase for CIP CT-1 Revenue Requirements, or in the Alternative, to Continue Accruing AFUDC for the CIP CT-1 Project ("HECO's Motion"), which was filed on November 19, 2009, and therefore approves an additional interim increase of \$12,671,000, resulting in an adjusted 2009 test year interim increase of \$73,769,000 over revenues at current effective rates.²

I.

Background

On July 3, 2008, HECO filed an application for approval of rate increases and revised rate schedules and rules ("Application") in which HECO requested a general rate increase of approximately \$97,011,000, or 5.2%, over revenues at current effective rates.

On May 15, 2009, the Parties filed their Settlement Agreement, in which the Parties stated that they reached agreements on all but two issues in this proceeding: (1) what is the appropriate test year expense for informational advertising; and (2) what is the appropriate return on common equity for the

¹ The parties to this docket are HECO, the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate"), an ex officio party pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules § 6-61-62, and the DEPARTMENT OF THE NAVY on behalf of the DEPARTMENT OF DEFENSE ("DOD") (collectively, "Parties").

² Revenues at current effective rates are revenues from base rates, revenues from the energy cost adjustment clause ("ECAC") and revenues from the interim rate increase that went into effect on November 1, 2008 in HECO's 2007 test year rate case, Docket No. 2006-0386.

test year.³ The Parties agreed that these two issues should be addressed at the evidentiary hearing.⁴ The Parties further agreed that the amount of the interim rate increase to which HECO is probably entitled under HRS § 269-16(d) is \$79,820,000 over revenues at current effective rates.

On May 18, 2009, HECO filed its Statement of Probable Entitlement, including a Proposed Interim Decision and Order, in which HECO requested an interim rate increase in the amount of \$79,811,000.⁵

On July 2, 2009, the commission issued its Interim Decision and Order ("Interim Decision and Order"), which approved in part and denied in part HECO's request to increase its rates on an interim basis, as set forth in HECO's Statement of Probable Entitlement. As discussed in the Interim Decision and Order, the commission determined that HECO had not met its burden of proving that it was probably entitled to recover several cost items that were included in the Statement of Probable Entitlement. Thus, the commission instructed HECO to exclude those costs, and file revised schedules with the commission, together with written explanations as to the amounts removed, and any other downward adjustments made to the schedules due to the exclusion of the

³ See Settlement Agreement at 1.

⁴ The Parties further waived their rights to: (a) present further evidence on the settled issues, except as provided in the Settlement Agreement; and (b) conduct cross-examination of the witnesses who are not testifying on the contested issues at the evidentiary hearing. See *id.* at 2.

⁵ HECO explained that the amount of interim increase requested in its Statement of Probable Entitlement is lower by \$9,000 than the amount in the Settlement Agreement due to the finalization of the revenue requirement run. See Statement of Probable Entitlement, at 1.

costs for interim relief purposes.⁶ The commission allowed the Consumer Advocate and the DOD to file comments on HECO's revised schedules within five days of the date of filing.⁷

On July 8, 2009, HECO filed its Revised Schedules and explanations of certain adjustments to HECO's 2009 test year estimates, as required by the Interim Decision and Order. HECO attached as Exhibit 1 to the Revised Schedules its Results of Operations for the 2009 test year resulting from the required adjustments. Exhibit 1 of the Revised Schedules shows a revised proposed interim revenue increase of \$61,098,000 over revenues at current effective rates. HECO attached as Exhibit 2 to the Revised Schedules a proposed tariff sheet, and provided explanations of its adjustments in Exhibit 3 of the Revised Schedules.

On July 15, 2009, the Consumer Advocate filed comments on the Revised Schedules.⁸ On July 17, 2009, HECO filed a response to the Consumer Advocate's July 15, 2009 letter, in which HECO provided additional justification regarding the adjustments made in the Revised Schedules.

By letter dated July 17, 2009, the commission rescheduled the hearing in this docket to begin the week of October 26, 2009.

⁶ The commission ordered that any upward adjustments made to the revised schedules be accompanied by testimony establishing the prudence of the adjustment for purpose of allowing the commission to determine whether HECO is probably entitled to recover that amount.

⁷ In addition, the commission set forth in the Interim Decision and Order, certain issues that the commission determined were not fully supported in the present record, and for which additional testimony by the Parties is needed. The commission allowed the Parties to file supplemental testimonies on these issues by July 20, 2009.

⁸ The DOD did not file comments on the Revised Schedules.

By Order Approving HECO's Revised Schedules, issued August 3, 2009, the commission approved the revised schedules filed by HECO on July 8, 2009 ("Revised Schedules"), as required in Section II of the commission's Interim Decision and Order, thereby allowing HECO to increase its rates to such levels as would produce, in the aggregate, \$61,098,000 in additional revenues, or a 4.71% increase over revenues at current effective rates⁹ for a normalized 2009 test year.

During the period from July 27, 2009 through October 28, 2009, the commission issued and the Parties responded to information requests.

On September 28, 2009, the commission advised the Parties that the commission intended to organize the evidentiary hearing in this proceeding by issue panels as the commission had done in investigative dockets in the past.¹⁰

By letter dated October 7, 2009, HECO, on behalf of itself, the Consumer Advocate, and DOD, informed the commission that the Parties agreed to the panel hearing format described in the September 28th Letter "in light of the steps proposed by the Commission to preserve the due process rights of the Parties."¹¹

On October 12, 2009, the commission identified the issues that would be covered in the hearing.¹² On October 19, 2009, the

⁹ Revenues at current effective rates are revenues from base rates, revenues from the energy cost adjustment clause and revenues from the interim rate increase that went into effect on November 1, 2008 in HECO's 2007 test year rate case, Docket No. 2006-0386.

¹⁰ See letter from commission to Parties dated September 28, 2009 ("September 28th Letter").

¹¹ See letter from HECO to commission dated October 7, 2009 (footnotes omitted).

¹² See letter from commission to parties dated October 12, 2009.

Parties provided their respective witness lists and proposed hearing schedules.

On October 19, 2009, the commission held a prehearing conference pursuant to Hawaii Administrative Rules § 6-61-36, with representatives from HECO, the Consumer Advocate, and the DOD. On October 20, 2009, the commission issued a Prehearing Conference Order, as a result of the prehearing conference, to control the subsequent course of the panel evidentiary hearing in this proceeding, unless modified or otherwise ordered by the commission. By letter dated October 21, 2009, the commission issued a "Brief Outline of Questions for the Panel Evidentiary Hearing" for the Parties' use and information.

The commission held hearings from October 26 -30, 2009, and from November 2-4, 2009, using a panel hearing format for issues raised by the commission's review of the record and settlement agreement, and a traditional hearing format for the two contested issues.

The issues with respect to the CIP CT-1 project were addressed in Panel 5 (CT-1 Panel), and were heard on October 27 and 28, 2009.¹³ On November 4, 2009, the Parties presented their closing arguments.

The official transcript of the hearings was filed on November 23, 2009.

II.

¹³ See Transcript (Vol. II) at 357-506 and (Vol. III) at 513-545. Additional information was obtained through questions posed in Panel 11 (Management Audit Panel) on October 30, 2009. See Transcript (Vol. V) at 793-852.

HECO's Motion

1.

HECO's Request

By its motion filed November 9, 2009, HECO requests that the commission issue a second interim decision and order as soon as possible authorizing an additional interim increase in revenue in the amount of \$12,671,000,¹⁴ which represents the revenue requirements for the Campbell Industrial Park ("CIP") Combustion Turbine Unit 1 ("CT-1") Project that were included in the Settlement Agreement between the Parties filed May 15, 2009 ("Settlement Agreement"), but were not included in the first interim increase in revenue of \$61,098,000 authorized by the Interim Decision and Order filed July 2, 2009, and Order Approving HECO's Revised Schedules filed August 3, 2009.¹⁵ In the alternative, if the commission determines that the capital costs for CIP CT-1 should not be included in rate base at this time as either "used or useful" Plant in Service, or as Property Held for Future Use, then HECO requests that the commission allow the Company to accrue an Allowance for Funds Used During Construction ("AFUDC") on the components of the CIP CT-1 Project that have been transferred to Plant in Service.

HECO's position is that the CIP CT-1 generating unit project is intended to provide three significant attributes: (1) to address the reserve margin shortfall situation; (2) to provide

¹⁴ As shown on Exhibit 1, page 1 to its Motion. In its requested interim relief, HECO is not requesting that any biofuel inventory for CIP CT-1 be included in the 2009 test year fuel inventory.

¹⁵ In effect, HECO requests that the amount of the interim increase in revenue be increased from \$61,098,000 to \$73,769,000. See Exhibit 1, page 1, to HECO's Motion.

blackstart capability in the event of an island-wide blackout; and (3) to provide biofueled peaking generation.

With respect to the first attribute, HECO maintains that CIP CT-1 is connected to the grid and available to serve customers in circumstances permitted by the commission.¹⁶ (I.e., the generating unit is actually installed and operational, although it has been run only for testing and emergency use.) With respect to the second attribute, the blackstart units are in service. With respect to biodiesel, HECO states that it has "moved aggressively to rebid the contracts, to file the test fuel contract, to take the risk of purchasing the first contract amount without prior approval (which potentially means that it would not be able to recover that amount if the test fuel contract is not approved), and to show the Commission the clear path the Company has to the second operational fuel contract."¹⁷

Given these developments, HECO proposed three options for the commission to allow the Company to earn a return on its investment in CIP CT-1 at this time:

(1) Option one - approve a second interim increase now on the basis that the unit is properly included in plant in service, and is used and useful given the first two attributes. The amount of the second interim would be \$12.7 million, which includes the rate base related revenue requirements of about \$11

¹⁶ In Decision and Order issued August 5, 2009, in Docket No. 2007-0346 ("Imperium D&O"), the commission stated that its order approving the stipulation requires HECO to operate CT-1 using only 100% biofuel, and "reminds HECO that it cannot operate CT-1 using a fuel other than 100% biofuels, absent prior approval of the commission." Id. at 5 n.5, citing Decision and Order No. 23457 at 2.

¹⁷ See HECO's Motion at 5.

million, and expense related revenue requirements of about \$2 million.

(2) Option two - approve a second interim increase now on the basis that the unit is still property held for future use, because an operational supply of biodiesel has not yet been obtained.¹⁸

(3) Option three - allow the Company to reclassify the costs of the project included in plant in service to construction work in progress ("CWIP") and to accrue AFUDC until an operational supply of biodiesel is obtained, and to allow a second interim later when the operational supply of diesel is obtained.¹⁹

According to HECO, Option one is the preferred option, and is consistent with case law holding that (1) property that services current needs, or both current and future needs, should be included in rate base as utility plant in service; and (2) generation held for reserve, standby or emergency capacity has been deemed to be used and useful for utility purposes. Option two reaches the same result, but requires securing of an operational supply of biodiesel for the unit before it can be

¹⁸ In Option 2, the costs of the CIP CT-1 project would be included in Property Held for Future Use until the operational supply of biodiesel is approved and obtained, at which time the costs would be placed in plant in service. Since that is not expected to occur until 2010, depreciation of the depreciable costs for the project would not be expected to begin until 2011. HECO's position is that including the capital costs for the project in Property Held for Future Use should not affect the amount of the interim increase, since the interim increase should still include the costs of staffing and maintaining the unit to have it available for use in an emergency.¹⁹

¹⁹ In Option 3, the accrual of AFUDC would be discontinued when an operational supply of biodiesel is obtained and the project costs are transferred again into plant in service. At that time, HECO states that it would have to file a motion to include the "full" CIP CT-1 costs in interim rates to avoid a gap in earning a return on the costs. The full costs would be limited in this proceeding to the test year estimate, despite the accrual of additional AFUDC.

included in plant in service. Option three presents complications, but would compensate the Company for the carrying cost of the investment.²⁰

In Interim Decision and Order issued July 2, 2009 ("Interim D&O"), the commission excluded the revenue requirements arising out of the capital and operations and maintenance ("O&M") costs for CIP CT-1 from the interim rate increase, stating that:

The commission is concerned that HECO's CT-1 unit is not currently "used and useful." To allow HECO to recover costs associated with CT-1 as of July 2009, prior to it becoming "used and useful" is inappropriate and inconsistent with Decision and Order No. 23457, filed on May 23, 2007. In addition, the commission is concerned that CT-1 may not be operational by the end of the 2009 test year because the fuel supply contract has not been resolved. The record is currently insufficient to demonstrate that the CT-1 unit will be in service by the end of the 2009 test year.

Moreover, in the Imperium D&O, issued August 5, 2009 in Docket No. 2007-0346, the commission rejected the contract between HECO and Imperium Services, LLC ("Imperium") for a biodiesel fuel supply for CIP CT-1, as amended (the "Amended Contract"). The commission noted, "in general, that the terms of the Amended Contract are substantially less favorable to HECO (and therefore its ratepayers) in price, risk, scope, and additional costs than the Original Contract due to the new point of delivery of fuel."

HECO states in its motion that it "accepts full responsibility for the inadequacies in the amended Imperium contract filing that it made with the Commission." The Company further acknowledges that, "given the lack of a viable biofuels contract, the Commission's action in denying the Company interim

²⁰ See HECO's Motion at 6.

relief on CT-1 in its July 2, 2009 decision was reasonable." The Company also acknowledges that "conditioning any recovery of CIP CT-1 cost on an adequate showing of the Company's commitment to biofueling is very appropriate under the circumstances."²¹

HECO also states that, until proper approvals and permits are received to operate CIP CT-1 on biofuels and biofuels are available, the unit will not be operated to serve customer load except pursuant to the commission's orders or instructions.²²

HECO maintains that its efforts since the Imperium D&O (1) to order the test supply of biodiesel, and (2) to expeditiously carry out the request for proposal ("RFP") for an operational supply of biodiesel, demonstrate that supplies of biofuels will be available and that the Company is making the appropriate commitments to obtain them.²³ HECO claims that it "took to heart the lessons learned in the Imperium case and the current biofuels arrangements can be regarded as real and as viable. Furthermore, by taking the risk of purchasing the initial supply without Commission approval, the Company is fully demonstrating its commitment to meeting the conditions of the order authorizing CT-1. Stated otherwise, to the extent that the Commission was saying that a 'used and useful CT-1' needed to be a 'used and useful biofueled CT-1,' the Company is making clear its compliance with the full condition that went with the approval of CT-1."²⁴

2.

²¹ See HECO's Motion at 4.

²² See HECO's Motion at 3.

²³ These efforts are identified below in the Facts section.

²⁴ See HECO's Motion at 4-5.

HECO's Legal Arguments

In its Motion and its Memorandum of Law attached to its motion, HECO contends that CIP CT-1 was installed as expeditiously as possible, in order to address the reserve capacity shortfall situation that has existed since 2006. The combustion turbine-generator was completed and placed in service (i.e., tied into the electrical grid and producing power) on August 3, 2009. The unit is now installed, is connected to the grid, is available to provide electricity to HECO's customers if needed and, thus, has resolved the reserve margin shortfall situation.

Given its obligation to serve, HECO maintains that it expended substantial funds in order to bring the CIP CT-1 Project on-line as soon as possible, and having installed CIP CT-1 in order to meet its obligation to serve, HECO should be provided with a reasonable opportunity to earn a fair return on its investment in the unit.

HECO cites examples where this commission, and regulatory commissions in other jurisdictions, have approved the inclusion in rate base of the costs of projects that were installed in logically sized increments, even though all or part of the capacity may not have been needed immediately once it was installed.²⁵ HECO also cites examples where generation held for

²⁵ See Memorandum of Law at 7-13. As noted by HECO the common theme in these cases is that (1) the utility had taken prudent steps to meet the future needs of its customers in adding new plant, (2) the plant was actually being used, and (3) the challenged plant will be used in the future.

reserve, standby or emergency capacity has been deemed to be used and useful for utility purposes.²⁶

If CIP CT-1 is not included as plant in service, then HECO maintains that CIP CT-1 should be included in rate base as property held for future use. As defined in the NARUC Uniform System of Accounts, "Property Held for Future Use" is a balance sheet account (account no. 105) that includes the original cost of property owned and held for future use in utility service under a definite plan for such use. The account includes: (1) "property acquired but never used by the utility in utility service, but held for such service in the future under a definite plan"; and (2) "property previously used by the utility in utility service, but retired from such service and held pending its reuse in the future, under a definite plan, in utility service."²⁷

Quoting Baltimore Gas & Elec. Co. v. McQuaid, 220 Md. 373, 380, 152 A.2d 825, 828-29 (1959), HECO argues that: "Such property may be included in the rate base if the regulatory body determines that its acquisition was reasonably necessary and its use may be anticipated with reasonable precision, or if, it has sometimes been held, the property is likely to be placed in service within the period for which the rates are fixed."

²⁶ See Memorandum of Law at 14-15.

²⁷ NARUC's guidelines regarding property held for future also provide rules for situations where: (1) property held in this account ceases to be needed or appropriate for future utility operations; and (2) the utility experiences gains or losses from the disposition of property held in this account. In addition, per NARUC's guidelines, property held for future use is classified according to the detailed accounts prescribed for utility plant in service, and the account is maintained in such detail as though the property were in service. Separate accounts are required to be maintained for each utility department for which plant is held for future use. Under NARUC's guidelines, normally, service life during which depreciation is computed commences with the date the property is includible in utility plant in service. Thus, depreciation would not commence on property held for future use until it is transferred to utility plant in service. See Memorandum of Law at 15-16.

In addition, HECO maintains that the second interim increase and an opportunity to earn on HECO's investment in CIP CT-1 are essential to assure confidence in the financial integrity of the Company and to maintain its credit.²⁸

HECO also notes that there is substantial precedent in Hawaii for the issuance of a second interim rate increase.²⁹

3.

Consumer Advocate's Position on the Motion³⁰

On December 1, 2009, the Consumer Advocate filed Comments on HECO's Motion, in which the Consumer Advocate stated that it does not object to HECO's request for an additional interim increase of \$12,671,000 representing revenue requirements for the Campbell Industrial Park Combustion Turbine Unit Project pursuant to HECO's proposals offered as Options 1 and 2.

With respect to Option 1, the Consumer Advocate states that it recognizes the need for this unit and would support a finding that, for the purpose of energy security, reliability and sustainability for the 2009 test year, the CT-1 unit is used and useful. Further, the Consumer Advocate offers that the use of

²⁸ See Memorandum of Law at 20-24.

²⁹ See Memorandum of Law at 16-20, citing Interim Decision and Order No. 11081, filed May 10, 1991 in Docket No. 6531 (HECO's 1990 test year rate case); Interim Decision and Order No. 12163, issued January 29, 1993, Interim Decision and Order No. 12378, issued May 7, 1993 (following a motion filed April 23, 1993), and Interim Decision and Order No. 12774, issued October 21, 1993 (which noted that a further motion was not necessary), in Docket No. 7000 (MECO's 1992-1993 test year rate case) by which the commission authorized a general interim increase and two step increases in 1993 for Maui Electric Company, Limited ("MECO") (timed to coincide with the addition of generating units to MECO's system); and Interim Decision and Order No. 13716, issued December 30, 1994, and Interim Decision and Order No. 14195, issued August 30, 1995, in Docket No. 7766 (HECO's 1995 test year rate case), by which the commission approved a general interim rate increase for HECO at the beginning of the test year, and a further interim increase after new transmission lines were placed in service.

³⁰ The DOD did not file a response to HECO's Motion.

the asset in this capacity has been reasonably demonstrated by evidence provided by HECO to justify rate base inclusion and an order to this end would appear to be within the commission's jurisdictional authority.³¹

The Consumer Advocate maintains that the following evidence of record supports a finding that CIP CT-1 is used and useful in the 2009 test year:³²

(1) The recorded peak load for 2009 to-date is higher than forecast;

(2) Based on the Consumer Advocate's understanding of HECO's system and the capabilities of the existing generating units, availability of CIP CT-1 may be critical to mitigate risks to the system due the occurrence of a natural disaster or other serious disturbance;

(3) Availability of CIP CT-1 may prove to be necessary during critical and high-risk scenarios such as (a) insufficient spinning reserve to cover the loss of any generation unit, (b) insufficient generation to serve load, and (c) the occurrence of an island-wide blackout; and

(4) The commission's acknowledgement that HECO will work with the commission and the Consumer Advocate if there is an interruption of the biofuel supply, an emergency, or an operational problem affecting the use of CIP CT-1.

Alternatively, the Consumer Advocate would not object to HECO's proposed Option 2, as the commission could consider its precedent of treating certain property investments that are not presently and fully used and useful as Property Held for Future Use ("PHFFU") within rate base. PHFFU assets have been reflected in rate base by the commission, which allows a return on the investment, but not a return of the investment (depreciation)

³¹ Consumer Advocate's Comments at 4, citing Consumer Advocate's response to PUC-IR-117.

³² Consumer Advocate's Comments at 6-7.

until that investment can later be classified as plant in service.³³

The Consumer Advocate does object to HECO's proposed alternative relief in the form of continued AFUDC for the CT-1 investment. It asserts that such relief is inconsistent with the Settlement .Agreement and would likely yield excessive future charges to HECO ratepayers while creating precedent for a new form of rate relief that has not been supported in the evidentiary record in this Docket.³⁴

4.

Consumer Advocate's Legal Arguments

In its Comments, the Consumer Advocate focuses on the "used or useful" standard in HRS § 269-16(b), which provides that a utility's just and reasonable rates "shall provide a fair return on the property of the utility actually used or useful for public utility purposes." According to its review of the used or useful standard as it has been interpreted and applied in the Courts of this State, the analysis as to whether an asset should be included in a utility's rate base should be conducted on a case-by-case basis, taking into consideration the situation. Moreover, the asset should provide more than an incidental benefit to the utility to be considered for inclusion in the utility's rate base.³⁵

III.

Facts

³³ Consumer Advocate's Comments at 4.

³⁴ Consumer Advocate's Comments at 2, 17-20.

³⁵ Consumer Advocate's Comments at 7-9.

In support of its motion, HECO attached a Statement of Facts, which is based on the evidentiary record in this proceeding, and the declarations of Robert C. Isler, Cecily A. Barnes and Ross H. Sakuda. The declarations supported updated information regarding (1) the status of the two blackstart generators and the water treatment system for the generator component of the CIP CT-1 project, and the total costs recorded for the CIP CT-1 project components and subcomponents that had been included in plant in service as of October 31, 2009, (2) the delivery of biodiesel for the emissions test for CIP CT-1, and the status of the RFP for the two-year operational supply of biodiesel, and (3) recorded HECO system peak loads, respectively.

1.

CIP CT-1 Project Status and Cost

The Campbell Industrial Park Generating Station and Transmission Addition Project ("CIP CT-1 Project") includes (1) the construction of a new generating facility (including the acquisition of a nominal 100 MW simple-cycle combustion turbine generator and related equipment and auxiliary facilities), (2) an approximately two-mile long 138 kV transmission line ("Transmission Line"), (3) expansion of HECO's existing Barbers Point Tank Farm site, (4) substation upgrades for the AES substation, Campbell Estate Industrial Park ("CEIP") Substation and Kahe Substation ("Substation Upgrades"), and (5) auxiliary equipment and facilities related to the foregoing.

Project components that HECO deemed to be placed in service as of the date of filing HECO's supplemental testimonies (July 20, 2009) included:

- AES Substation (P0001051) - April 9, 2009
- CEIP Substation (P0001052) - April 22, 2009
- CIP Land (P0001084) - November 28, 2008
- Microwave Communications (P0001135) - June 3, 2009
- Kalaeloa Relays (P0001137) - April 1, 2009

The combustion turbine-generator was completed and placed in service (i.e., tied into the electrical grid and producing power) on August 3, 2009. The transmission line and fiber communication components were completed on July 27, 2009, and the Kahe breakers work was completed on October 1, 2009.

For the generating station component, two subcomponent systems were not completed as of August 3, 2009, including the two blackstart generators and the water treatment system. The blackstart generators (estimated to cost approximately \$3,000,000) were completed and placed in service as of October 15, 2009.³⁶

Based on its standard accounting practices, HECO discontinued the accrual of AFUDC as of the dates components were placed in service.³⁷

The water treatment system (estimated to cost approximately \$6,500,000) also is expected to be placed in service by December 15, 2009.³⁸ The later in-service date for this subcomponent does not affect the operation of the generating unit. Until the water treatment system is in service, demineralized water is provided

³⁶ Declaration of Robert Isler at 1.

³⁷ Declaration of Robert Isler at 1.

³⁸ Declaration of Robert Isler at 1.

to the CIP CT-1 generating station by trucking in water from one of the nearby independent power producers or from other HECO generating stations.

(a) CIP CT-1 Project Cost

The estimated capital costs of the CIP CT-1 Project for purposes of this rate case are \$163,279,651, as shown on HECO-S-1701. Of that amount, however, \$1,809,875 represents the cost of the parcel between Hanua Street and the AES Substation that is included in Property Held for Future Use, and no longer included in the cost of any of the project cost components.³⁹

In the Settlement Agreement, of the remaining \$161,469,776, (1) \$6,119,685 represents the cost of land and easements acquired for the project in 2008, which was included in Property Held for Future Use in the beginning of the test year rate base balance amount, and in plant-in-service in the end of test year rate base balance amount, and (2) \$155,350,091 represents the costs of the other components.⁴⁰

The total cost estimate for the project has been updated by HECO to approximately \$193.1 million, as shown in HECO-S-17A01, and as supported in HECO ST-17A.⁴¹ Nonetheless, given the settlement with the other Parties, and the timing of the availability of the updated cost estimate, HECO has not proposed

³⁹ See HECO-S-1701.

⁴⁰ HECO notes that the total project cost estimate includes \$50,000 that was estimated to be expended in 2010, and was not included in the test year rate base estimate. As a result, the test year cost estimate in the Settlement Agreement for the project is \$161,419,776 (i.e., \$163,279,651, less \$1,809,875 included in Property Held for Future Use, and less \$50,000 estimated to be incurred in 2010). See Statement of Facts at 10.

⁴¹ HECO submitted a detailed explanation of the updated costs in testimonies submitted in this proceeding and in the cost report submitted in Docket No. 05-0145. HECO's position is that, although the costs for the CIP CT-1 project were substantially underestimated, the actual costs incurred were prudent.

that the cost estimate included in the stipulated settlement be adjusted to reflect the updated current cost estimate supported in its supplemental testimonies.

The adjustments made to the net cost of plant in service to remove costs associated with CIP CT-1 included a (1) downward adjustment of approximately \$6,120,000 from the December 2008 recorded balance, and a (2) downward adjustment of approximately \$161,420,000 ($\$6,120,000 + \$155,300,000$) from the December 2009 estimated balance. This resulted in an adjustment to the average balance of the net cost of plant in service from \$1,470,532,000 in the Statement of Probable Entitlement⁴² to \$1,386,762,000 in the revised schedules filed on July 8, 2009⁴³, a decrease of \$83,770,000 ($(\$6,120,000 + \$161,420,000) / 2$) to the average net cost of plant in service balance.

(b) Operation and Maintenance Costs for CIP CT-1

The production O&M costs associated with CIP CT-1 for the test year in the Settlement Agreement are \$1,369,000, as reflected in the Statement of Probable Entitlement (\$1,474,000 - \$105,000).

(c) Fuel Inventory

In the Settlement Agreement, the Parties agreed to accept HECO's updated average fuel inventory balance of \$45,005,000 for the 2009 test year.⁴⁴ HECO derived this amount by computing the average of the beginning of 2009 test year fuel inventory (without CIP CT-1) of \$43,274,000 and the end of 2009 test year

⁴² Statement of Probable Entitlement, Exhibit 1, at 3.

⁴³ HECO's Revised Schedules Resulting from Interim Decision and Order, Exhibit 1, at 3.

⁴⁴ Settlement Agreement, Exhibit 1, at 70.

fuel inventory (with CIP CT-1) of \$46,737,000.⁴⁵ Because CIP CT-1 will use biodiesel for fuel and was scheduled to go into service on July 31, 2009, the beginning of test year fuel inventory does not include any biodiesel but the end of test year fuel inventory does. Removal of CIP CT-1 from the test year required the removal of biodiesel from the end of test year fuel inventory. To be conservative, the Company used the beginning of test year balance of \$43,274,000 (which does not include biodiesel) for the end of test year fuel inventory, resulting in an average annual total inventory of the same amount (\$43,274,000) for the 2009 test year.⁴⁶

In the present Motion, HECO is not requesting that any biofuel inventory for CIP CT-1 be included in the 2009 test year fuel inventory.

(d) Accumulated Deferred Income Taxes

The total ADIT associated with CIP CT-1 was calculated to be \$4,518,000 and the impact on average rate base was \$2,259,000 in the 2009 test year. In accordance with the Interim Decision and Order, HECO excluded this ADIT from rate base in calculating the revenue requirements for purposes of the 2009 initial test year interim rate relief. The exclusion of the ADIT associated with CIP CT-1 had the effect of decreasing ADIT (increasing rate base). In calculating the amount of the requested second interim increase, HECO has added back the \$2,259,000 of ADIT associated

⁴⁵ Settlement Agreement, HECO T-5 Attachment 1, at 8.

⁴⁶ See Statement of Facts at 7.

with CIP CT-1 that was excluded in accordance with the Interim Decision and Order (which reduces rate base).⁴⁷

(e) Consumer Advocate's Review

The Consumer Advocate has reviewed HECO's calculations, and states that it does not dispute the accuracy of HECO's proposed second interim increase.⁴⁸

The Consumer Advocate also supports the inclusion of partial year O&M expenses for CIP CT-1, even if Option 2 is selected.⁴⁹

Given the availability of CT-1 to meet reserve shortfall conditions and to provide emergency black start capabilities, as well as HECO's ongoing efforts to acquire and test biofuels in the unit, recovery of this reduced level of O&M would appear reasonable, based on these unique facts and circumstances, and should be allowed by the Commission without regard to whether Option one or Option two is authorized.

2.

Biodiesel Supply

(a) Biofuel Requirement

Although the CIP CT-1 generating unit is considered to have been placed in service by HECO and is capable of serving customer load,⁵⁰ HECO is still in the process of obtaining biodiesel supplies for the unit.

⁴⁷ See Statement of Facts at 7-8.

⁴⁸ Consumer Advocate's Comments at 14.

⁴⁹ Consumer Advocate's Comments at 16.

⁵⁰ Since July 31, 2009, HECO has periodically dispatched the CIP CT-1 unit to perform various tests and commissioning activities that require the unit to be tied to the electric utility grid and run at various loads. The response to PUC-IR-154 (filed October 19, 2009) listed the dates and times the CIP CT-1 unit was dispatched for testing purposes and a brief description of the testing or commissioning activities that were performed. When CIP CT-1 was run for testing and commissioning activities, although it was not the purpose of the run, the unit did provide electricity to the HECO grid.

Until biodiesel is available, however, the CIP CT-1 unit will be held from use for purposes other than testing unless an emergency condition arises, namely, a situation in which CIP CT-1 would be used as a last resort generation resource to mitigate spinning reserve and generation capacity

In the CIP CT-1 docket, Docket No. 05-0145, the Consumer Advocate recommended,⁵¹ and HECO agreed, to fuel the new generating unit using 100% biofuel. The commission agreed that burning biofuel is preferable to fossil fuels and approved its use according to the Joint Stipulation, subject to the commission's approval of the specific fuel purchase contract for the biofuel.⁵²

By D&O 23457, the commission approved HECO and the Consumer Advocate's Joint Motion for Approval of Stipulation, thereby approving HECO's request to commit funds for the purchase and installation of CT-1 and a new 138 kilovolt transmission line. The commission stated that its "decision [was] based on the undisputed urgent need for new generation by HECO, and the fact

shortfall situations that have a high potential to lead to or have already led to load shedding and island wide blackouts.

The response to PUC-IR-154 lists the date (October 9, 2009) and time when the CIP CT-1 unit was dispatched for emergency purposes and contains a brief description of the system condition that prompted its dispatch. A more detailed explanation was provided in HECO's letter to the commission dated October 12, 2009, which has been filed in this proceeding as HECO Hearing Exhibit No. 6.

⁵¹ The Consumer Advocate did not object to the commitment of funds for the project, provided the combustion turbine used 100% biofuels. The Consumer Advocate recommended that HECO be required to use ethanol or some other biodiesel fuel, as opposed to naphtha, for the generating unit, and that HECO be required to work with the Department of Business, Economic Development & Tourism to develop a local resource for biofuels. CA-T-1, filed August 17, 2006 in Docket No. 05-0145.

⁵² In approving the Joint Stipulation, the commission stated, "[a]s to HECO's commitment to use 100% biofuels, the commission finds that commitment to be reasonable and consistent with State policy to reduce Hawaii's dependence on imported fossil fuels and encourage sustainability through economic diversification, export expansion, and import substitution." Decision and Order No. 23457, filed on May 23, 2007 in Docket No. 05-0145 ("D&O 23457") at 45. The commission further found that "using biofuels, which may eventually be locally grown and produced, is preferable to burning fossil fuel for the [CT-1] Project, and will advance the State's policies of reducing the State's dependence on fossil fuels and diversifying the State's economy." D&O 23457 at 47-48.

that State policy and law support HECO's commitment to use 100% biofuels in the new generating unit."⁵³

As discussed in Docket No. 05-0145, because biodiesel is a new fuel to be used in CIP CT-1, HECO must obtain a modification of its air permit from the Hawaii Department of Health ("DOH") to operate CIP CT-1 on biodiesel.⁵⁴ HECO presented its plan for obtaining the requisite air permit modification from the DOH in Docket No. 05-0145, as described in Exhibit A to the Joint Stipulation).⁵⁵

Once HECO considered CIP CT-1 to be operational, it conducted performance guarantee testing using low sulfur diesel to determine if CIP CT-1 met Siemens' performance guarantees. There has been a gap between (1) the time that the CIP CT-1 generating unit became operational, and the performance guarantee testing under the Siemens contract was subsequently completed, and (2) the time that biodiesel will be available for the conduct of the emissions testing. There will be another gap in time between the completion of the biodiesel emissions tests⁵⁶ and the

⁵³ D&O 23457 at 2. HECO assesses the current need for the capacity provided by CIP CT-1 in its Statement of Facts at 25-36.

⁵⁴ See Exhibit A to Biofuels Stipulation; see also response to PUC-IR-117 at 6-7; HECO ST-17E at 9; HECO ST-17A at 41.

⁵⁵ See Exhibit A (Position on Biofuels for the New Combustion Turbine Unit) to Stipulation between HECO and Consumer Advocate, dated December 4, 2006, submitted with Joint Motion for Approval of Stipulation, filed December 4, 2006 in Docket No. 05-0145.

⁵⁶ The purpose of the biodiesel testing is to gather emissions data that will be provided to DOH. DOH will review that information and HECO has testified that it anticipates that it will take DOH anywhere from 2 to 6 months to review the request for permit modification. See Exhibit A to Biofuels Stipulation; see also testimony and cross-examination of Robert Isler during the supplemental Imperium Contract hearing in Docket No. 2007-0346 on March 10, 2009, Vol. II at 445-460; HECO ST-17A at 39-41.

modification of the air permit for CIP CT-1 to permit the burning of biodiesel on an on-going basis.⁵⁷

Depending on the time required for approval of a new contract for the operational supply of biodiesel, and initial deliveries of biodiesel under the new contract, there could be a further gap in time between the modification of the air permit and the availability of biodiesel for full time operation of the unit.

(b) HECO's Biodiesel Contracts

On October 18, 2007, HECO filed its Application in Docket No. 2007-0346 seeking commission approval of the contract between HECO and Imperium for a biodiesel fuel supply for CIP CT-1 ("Original Contract"). On January 30, 2009, HECO filed Amendment No. 1 to Biodiesel Supply Contract Between Hawaiian Electric Company, Inc. and Imperium Services, LLC and Assignment to Imperium Grays Harbor, LLC. ("Amendment"). On February 6, 2009, HECO filed the Biodiesel Terminalling and Trucking Agreement ("TTA") with Aloha Petroleum, Ltd. (the Amendment and the TTA collectively referred to as "Amended Contract").

By Decision and Order issued August 5, 2009 ("Imperium D&O"), in Docket No. 2007-0346, the commission rejected the Imperium biofuels contract, as amended. The commission stated, "in general, that the terms of the Amended Contract are substantially less favorable to HECO (and therefore its ratepayers) in price,

⁵⁷ See Exhibit A to Joint Stipulation, which states that the process of collecting emissions data and modifying the air permit could take up to 6 months. See also Response to PUC-IR-117 at 5-7, 11-12; and HECO ST-17E at 9-11.

risk, scope, and additional costs than the Original Contract due to the new point of delivery of fuel."⁵⁸

In response to the commission's decision, HECO has reissued requests for proposals for biodiesel. To acquire the biodiesel for the biodiesel emissions data project, HECO issued a Request for Proposal Biodiesel Supply Contract on August 14, 2009. On October 1, 2009, HECO executed a contract with REG ("Biodiesel Supply Contract"). On October 2, 2009, HECO filed an application in Docket No. 2009-0296 requesting commission approval of the Biodiesel Supply Contract.

On October 22, 2009, HECO filed a letter informing the commission of the October 6, 2009 order placed with REG for 400,000 gallons of biodiesel under the terms of the biodiesel supply contract, and provided a copy of the letter of agreement signed by HECO and REG to effect the order date of October 6, 2009. On November 6, 2009, REG began delivering the biodiesel, and the delivery of all 400,000 gallons is anticipated to be completed by November 20, 2009.⁵⁹

HECO stated in its motion that it will conduct the biodiesel emissions data project beginning the week of November 30, 2009 in order to begin biodiesel operations in 2010.⁶⁰ Testing was estimated to take up to one month.

In order to operate CIP CT-1 on biodiesel on an on-going basis, HECO issued an RFP for a two-year supply on August 14, 2009. The RFP requested proposals for the supply and delivery of

⁵⁸ Id. at 16.

⁵⁹ Declaration of Cecily A. Barnes at 1.

⁶⁰ Declaration of Cecily A. Barnes at 2.

three million to seven million gallons of biodiesel per year for a term of two years from the contract effective date as subject to commission approval. Eight proposals were received by HECO.

HECO filed an application requesting approval for its [Biodiesel Supply Contract (CIP CT-1 Operational Volume) with []] on December [], 2009, in Docket No. 2009-[].

HECO states that the ordering of the biodiesel according to the terms of the operational volume biodiesel supply contract is expected to commence upon a commission decision approving the contract. The estimated lead time of the first biodiesel delivery under the planned operational volume biodiesel supply contract is 20 weeks from time of order placement.⁶¹

According to HECO, "the foregoing demonstrates that supplies of biofuels are available and that the appropriate commitments to obtain them have been met. The Company took to heart the lessons learned in the Imperium case and the current biofuels arrangements can be regarded as real and as viable. Furthermore, by taking the risk of purchasing the initial supply without Commission approval, the Company is fully demonstrating its commitment to meeting the conditions of the order authorizing CT-1. Stated otherwise, to the extent that the Commission was saying that a 'used and useful CT-1' needed to be a 'used and useful biofueled CT-1,' the Company is making clear its compliance with the full condition that went with the approval of CT-1."⁶²

IV.

⁶¹ Declaration of Cecily A. Barnes at 2.

⁶² See Motion at 4-5.

Discussion

1.

Approval of Option [1 or 2]

[If Option 1 - Given the delay in obtaining the biodiesel required to perform the emissions test, and the likely further delay in obtaining the operational supply of biodiesel after the permit is modified, the commission is challenged to find that the CIP CT-1 project is currently in service. However, the commission finds that the CIP CT-1 project can be used to provide service in an emergency, and that HECO has made substantial progress in obtaining the biodiesel required to perform the emissions test and the operational supply of biodiesel. Thus, the commission finds probable entitlement for the inclusion of the project costs in rate base as plant in service.]

[If Option 2 - Given the delay in obtaining the biodiesel required to perform the emissions test, and the likely further delay in obtaining the operational supply of biodiesel after the permit is modified, the commission finds that the CIP CT-1 project is not yet in service. Given the progress in obtaining the biodiesel required to perform the emissions test and the operational supply of biodiesel, however, the commission finds probable entitlement for the inclusion of the project costs in rate base as Property Held for Future Use.]

HECO will be allowed to include the CIP CT-1 costs (as identified in decision and order) in rate base as long as the commission is satisfied that HECO is making adequate progress in securing an operational supply of biodiesel. Ratepayers should

not be burdened with the costs of a facility that cannot serve its intended function due to imprudent action or inaction on the part of the utility to acquire the resources needed to make the facility fully operational.

2.

Matters Not Addressed

The amount of the second interim increase proposed by HECO under either Option 1 or Option 2 would be the same, and would be equal to the proposed interim revenue requirements for CIP CT-1 included in the Settlement Agreement (with the exception that HECO is not requesting that any biofuel inventory for CIP CT-1 be included in the 2009 test year fuel inventory).

The Settlement Agreement is based on the average rate base concept, and does not provide for the full recovery of CIP CT-1 costs. HECO's contemplated mechanism for recovering the remainder of the costs is through the Revenue Adjustment Mechanism ("RAM") included in the Joint Decoupling Proposal submitted by the HECO Companies and the Consumer Advocate in Docket No. 2008-0274. If the proposed RAM (or a similar mechanism) is not approved for implementation in 2010, then HECO states that it plans to submit another motion requesting recovery of such costs in this docket.⁶³

These matters are beyond the scope of this Second Interim Decision and Order, which is limited to the relief requested in HECO's Motion. Any relief requested in the decoupling docket

⁶³ See HECO's Motion at 7. HECO, Hawaii Electric Light Company, Inc. and Maui Electric Company, Limited (the "HECO Companies") filed a Motion for Interim Approval of a Decoupling Mechanism for the HECO Companies on November 25, 2009 in Docket No. 2008-0274.

will be addressed in that proceeding, and any further relief requested in this rate case will be addressed when an appropriate request is submitted.

V.

Subject to Refund

The commission emphasizes that the findings and adoption here of the various amounts reflected in Exhibit A are for the purpose of this Interim Decision and Order, only. All of the commission's decisions and rulings in this regard are subject to a more detailed review and analysis. The commission's final decision and order will reflect this review and analysis of all estimates and proposals of the Parties. Based on the record, it appears that HECO will probably be entitled to the level of relief that the commission grants in this Interim Decision and Order.

HECO will be required to refund to its customers any excess collected under this Interim Decision and Order, together with such interest as provided for by HRS § 269-16 (d), if the final increase approved by the commission is less than the total interim increase granted by this Interim Decision and Order.

Within thirty (30) days of the end of each calendar quarter, HECO shall file a report detailing its progress in obtaining the necessary air permit modification, and in acquiring an operational supply of biodiesel, until these items are secured. Thus, the commission will be able to track the Company's progress in obtaining biofuel in the biofuel contract proceeding, or through reports it requires in this order. If the commission is

not satisfied with the biofuel progress when the final decision and order in this proceeding is issued, the commission reserves the right to take further action, including removing the CT-1 costs from rate base.

V.

Orders

THE COMMISSION ORDERS:

1. HECO's Motion for Second Interim Increase for CIP CT-1 Revenue Requirements, filed on November 19, 2009, is granted, and the adjustments to HECO's 2009 test year interim rate increase, as set forth in Exhibit 1 to HECO's Motion, pages 2-14, are approved.

2. HECO shall promptly file copies of its revised tariff sheets to reflect the adjustments approved by this Order, to be effective upon filing.

3. HECO shall comply with the reporting requirement set forth in Section V, above.

DONE at Honolulu, Hawaii _____.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII